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Supreme Court of the United States

OCTOBER TERM, 1947

No. 84

UNIVERSAL PICTURES COMPANY INC. (sued herein as Universal Corporation and Universal Pictures Company Inc.), UNIVERSAL FILM EXCHANGES INC., and BIG U FILM EXCHANGE, INC.,

Appellants,

vs.

THE UNITED STATES OF AMERICA,

Appellee.

No. 79

THE UNITED STATES OF AMERICA,

Appellant,

vs.

PARAMOUNT PICTURES INC., *et al.*,

APPELLEES.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR UNIVERSAL PICTURES COMPANY, INC., *ET AL.*, APPELLANTS

THOMAS TURNER COOKE,
CHARLES D. PRUTZMAN,
Counsel for the Universal Appellants.

ADOLPH SCHIMEL,
CYRIL S. LANDAU,
FRANK W. FORD,
Of Counsel.

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The only answer which the Government attempts in opposition to our fully elaborated and documented argument demonstrating that Universal's feature film-licensing is conducted in an entirely legal manner, in all of its phases, and that we were no part of any conspiracy, horizontal or vertical, is (1) to claim that *Interstate Circuit* v. *U. S.*, 306 U. S. 208, is controlling, under the findings of the

Court below, and (2) to assert that it was incumbent upon us to license our films, picture by picture and theatre by theatre, in order to avoid unreasonable restraint of interstate commerce. We discuss these contentions in order.

1. The *Interstate Circuit* Case and the Relevant Findings of the Court Below.

This case, and the findings of the Court below with respect to admission prices, runs and clearances, claimed to bring us within it, are the sole reliance of the Government in its brief, in respect of its basic claim that Universal was implicated in an alleged combination and conspiracy among the major defendants to fix admission prices, runs and clearances in the domestic motion picture theatre market. (Gov. bf., pp. 16, 52, Point I (A), pp. 14-19).

Since Universal had no theatres, it was not at all interested in differentials in admission prices between prior-run and subsequent-run theatres *as a means of sustaining theatre-operating profits*, the protection of which, the Government claims, in respect of the major defendants, cannot be justified by the possession of copyright monopolies. Universal was, however, concerned that the admission prices which were being charged by its licensee theatres, whether prior or subsequent-run, should not be reduced while—and only while—its pictures were being shown therein, for a wholly different reason, *i.e.*, the legitimate purpose of obtaining for itself the maximum rewards under its copyright monopolies..

It was pointed out in our opening brief (pp. 106-8) that Universal never attempted to interfere in any way with the admission prices respectively charged by its prior and subsequent-run licensees, and indeed could not as a practical

matter have interfered, if it had wanted to. All that it did was to require a covenant from each of its licensees not to reduce its admission price during the run of the pictures licensed to it by Universal. At any time any licensee was not running Universal pictures, it could do anything it pleased with its admission price. This covenant, as we fully explained in our opening brief (pp. 64-81), was vitally necessary to protect the aggregate reward accruing to Universal from the showing of its copyrighted pictures on all of the various runs.

The Government's argument under the following heading is illuminating as to the Government's theory in this connection (Gov. bf., p. 16): "The use by each distributor of license restrictions intended to suppress admission price competition between competing theatres is substantially undisputed". In support of this contention, it says (Gov. bf., pp. 16-17): "The defendants' film licenses habitually impose explicit restrictions upon the use of their films, the effect of which is to stipulate admission prices for theatrical entertainment to which their sole contribution is the supplying of a positive print on a rental basis. Since the stipulated admission price is generally the price charged by the theatre for all films, such price-fixing bears no relation to the quality of the exhibition rights granted by any particular license". Thus it claims that run and clearance are "simply devices for fixing price differentials between competing theatres in order to maintain their relative playing position".

This argument is completely fallacious insofar as Universal is concerned. As pointed out in our opening brief, p. 69, it is completely untrue that the covenant against reduction of admission price fixes the admission price for the

theatre in which other pictures or entertainment, in addition to Universal's features, may be shown. The exhibitor is completely free to charge anything he pleases for such additional entertainment. Thus the minimum admission price covenant is for the sole purpose of protecting Universal's reward under its copyrights, and is not for the purpose of fixing the admission price of the licensed theatres, to protect theatre-operating profits. It is entirely immaterial that the theatre-owner may regard only part of his admission price as appertaining to Universal's picture. Universal regards all of it as thus appertaining, and having the right to select any minimum price it sees fit, can select this price.

Despite these obvious facts, the Government would have it that the Court below found that the purpose of this covenant in Universal's licenses was to protect theatre-operating profits (Gov. bf., p. 16), for it argues that the *Interstate Circuit* case is conclusive "unless it can be shown that the Court's subsidiary findings which demonstrate that the purpose of *their* license restrictions was *to control price competition* are erroneous."* Neither here or any other place in its brief does it cite any finding made by the Court to support this contention with respect to Universal, and we think it is clear that such a finding does not in fact exist.

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*In two respects this statement is vague. "Their" may or may not mean all the defendant distributors. The phrase "to control price competition" may or may not mean for the purpose of sustaining theatre-operating profits. When Universal licenses a feature picture to a first-run theatre charging 50 cents, and thereafter to a second-run theatre charging 25 cents, and in each case requires a covenant not to reduce the admission price, *while Universal pictures are running*, it is of course obvious that the two theatres cannot compete by reducing their respective prices, unless they are willing to risk the cancellation of their Universal licenses or the withdrawal of the run and clearance privileges extended them by Universal.

Under the Government's express admission, unless such a finding exists and there is evidence to support it, the case is taken out from under what the Government says is the doctrine of the *Interstate Circuit* case.

But even if there was such a finding, as the Government claims, and evidence to support it, the *Interstate Circuit* case would not, under any possible construction, be authority for the Government's position, either in respect of its claim that Universal was implicated in a horizontal conspiracy with the major distributors, or in respect of its claim that Universal was implicated in vertical conspiracies with the affiliated exhibitors it licensed.

The horizontal conspiracy in the *Interstate Circuit* case was inferred from the fact that the distributors, therein concerned, followed what were found to be parallel courses of action, after being confronted with the express written demand of the manager of two large circuits that each distributor agree with these circuits that it would impose restrictions upon subsequent-run theatres which were in competition with the subsequent-run theatres of the circuits.

The restrictions which the circuit manager demanded were: (1) that each distributor make an express agreement with his circuits that it would require competing subsequent-run theatres which had been charging considerably less than 25¢ admission to raise their admission price to 25¢; and (2) to abstain from their customary practice of double-featuring. Otherwise the circuit manager advised the distributors that he would not continue to show their Class "A" feature pictures at a 40¢ admission price. This Court found that the agreements demanded were in substance made by the distributors with the circuits.

This Court held that there was a horizontal conspiracy among the distributors and vertical conspiracies between

each distributor and the circuits. Three of the justices thought that the action of the distributors in both respects was entirely legal under the Copyright Laws. Great emphasis was placed by the majority upon the fact that a radical change was compelled in the admission-price policies of the competing subsequent-run exhibitors, and also upon the fact that the distributors were interfering, by express agreement with the circuits, with something which was none of their concern, i.e., the right of the subsequent-run exhibitors to show the pictures of others in double-feature programs along with the features of the defendant-distributors.

Although this Court expressly pointed out (p. 229) that "the case is not one of the mere restriction of competition between the first showing of a copyrighted film by Interstate and the subsequent showing of the same film by a licensee of the copyright owner," the Government claims that the case holds exactly that, for it says, (p. 16) that this Court held that "the use of admission price restrictions by a single distributor to suppress price competition between theatres was also unlawful," quite evidently intending to convey the idea that the use of the covenant against reduction of the admission price with theatres in successive runs, in respect of copyrighted pictures, was unlawful, even if exclusively in the distributor's interest.

Since, as explained in our opening brief (pp. 48-50), an exclusive license under copyright is clearly legal, as was conceded by this Court in the *Interstate Circuit* case itself (pp. 227-8), and its very purpose is to prevent others from competing with the exclusive licensee, in the licensor's interest, the Government's argument is not only not supported by the *Interstate Circuit* case, but is definitely contradicted thereby.

For like reasons, the run and clearance provisions, by which Universal licensed its feature pictures so as to reap the maximum reward from the various prior and subsequent-run theatres, in accordance with such playing positions as they had attained, are entirely legal, as has been demonstrated in our opening brief.

There is no similarity whatsoever between this case, insofar as Universal is concerned, and the *Interstate Circuit* case, in respect of the charge of horizontal conspiracy. In that case the focus producing similar action among the distributors was the blunt demand of the manager of the two dominant circuits in the Texas and New Mexico territory for parallel action *in making express agreements with his circuits whereby competing subsequent-run exhibitors were forced to change in a radical way admission price and double-feature policies.* In our case the focus producing uniformity of action in respect of admission price is the obviously reasonable consistent admission-price policy of the exhibitor, plus the use by all distributors of the wholly legal and obviously indicated covenant against reduction of such admission price during the runs of their respective feature pictures. In the case of clearance, as fully explained in our opening brief, the programming requirements of the exhibitor, together with the competitive forces operating in the market against a relatively small distributor, bring about uniformity.

In respect of vertical conspiracy the distinction is even more evident. We made no agreements whatsoever with prior-run exhibitors that we would impose any restrictions of any kind upon subsequent-run exhibitors, and there was no finding or evidence to this effect. The only restriction we did impose upon each of our licensees (for as shown in

our opening brief (p. 57-9) clearance is not a restriction upon them) was the legal covenant against admission price-reduction, and no one dictated our imposition of that.

The transactions with which the *Interstate Circuit* case were concerned took place in 1934, and since that time the financial control and executive management of Universal have shifted to entirely new hands.

2. The Contention that Universal Must License Its Copyrighted Motion Pictures Picture by Picture and Theatre by Theatre.

There are about 18,000 motion picture theatres in the United States, and each is a potential market for Universal's pictures, whether features, Westerns, short-subjects or news-reels. Universal licenses its pictures to the great majority of these theatres. As heretofore pointed out, its regular practice has been to produce about one feature picture a week, many Westerns and so-called short subjects, and a weekly news picture. The number of pictures listed in G. X. 261 (the franchise particularly referred to by the Government and printed in its Appendix at pp. 50-58) is 185 per year, counting each news-release as one picture. If it had to license these pictures, one by one, to the many thousands of theatres with which it deals, something like a million transactions or more would be involved.

Yet the Government would have it that this is the only legal way for Universal to license any of its copyrighted pictures. Since the same reasoning which it advanced to condemn the group-selling of features also condemns the group-selling of weekly news-releases and short subjects, the number of salesmen it would have to have to accomplish this task is food for the imagination.

In making this contention that the only legal kind of licensing for Universal is picture by picture and theatre by theatre, the Government refers to no legal authority whatsoever. In claiming that we condition the licensing of one picture upon the licensing of another, the Government offers no record reference to combat the flat assertion in our opening brief (p. 52) that there was no evidence that such a practice was followed by us.

There is no reason to discriminate against copyrighted articles in respect of bulk sales. As was said in the *Interstate Circuit* case by one of the Justices (p 236), "All the Copyright Act does is to create a form of property in the literary or artistic production of the author or artist. The Act attaches to the product of his brain certain attributes of property. * * * The monopoly, so called, amounts to nothing more than the attachment to the work of an author or composer or producer of motion pictures of the same rights as inhere in other property under the common law". An owner of a bushel of wheat does not have to offer each grain separately, because they may vary in quality, nor does the owner of many copyrights, in order that someone may have satisfaction of knowing exactly how much each brings, and that the reward is in direct relation to the quality of the copyright.

The Government argues, however, that our complaint as to the judgment below is founded principally upon our claim that "Since the major defendants may force their films into the market by the use of their affiliated theatres, the distributors without affiliated theatres are compelled to use franchises, block-booking and master agreements to force their films into the market." It then goes on to say that it does not dispute the soundness of this argument,

insofar as it is based upon an "economic necessity arising from competing in a market dominated by the major defendants" (Gov. bf., pp. 7-8, 63).

At one and the same time the Government argues that by means of block-booking, (1) we force feature pictures upon exhibitors who do not like them, and (2) that we license our pictures in a block before they are made, and hence before they can judge them. It is not abashed by the fact that the undisputed evidence shows, as pointed out in our opening brief (pp. 85-6), that independent exhibitors insist upon Universal's committing itself to license its pictures to them before they are produced, so that they may be assured of grist for the mill, which operates continuously day in and day out, frequently several shows a day.

Nor is it abashed by the fact that if Universal produced feature pictures ranging in cost from several hundred thousand dollars each to several million dollars each, and made the necessarily large capital expenditures incident thereto, without having an assured market for its pictures for at least a few years ahead, it would not likely be in business very long.

Articles costing these tremendous amounts to produce, particularly those whose success is largely a matter of public taste, cannot be produced upon the mere hope that exhibitors will take to them sufficiently to commit themselves to pay film rentals sufficient to recoup the expenditure plus a reasonable profit. This is one of the main reasons why a distributor finds it advantageous to control theatres, and the reason that makes it obligatory for a non-integrated distributor to make franchises if it is to compete on anything like equal terms with integrated companies.

In the late 1920's the Government attacked block-booking as practiced by Paramount, then the largest company

in the industry. As pointed out in our opening brief (pp. 88-94), this attack, made on a comprehensive record, failed, and the Circuit Court of Appeals for the Second Circuit unanimously held that Paramount had not acted illegally in the premises. *Federal Trade Commission* v. *Paramount Famous-Lasky Corp.*, 57 F. (2d) 152 (CCA 2nd, 1932). The Government did not apply for certiorari in this case, and the industry, with good reason, has ever since considered it to be the law, particularly in view of the like general holding, in respect of conditioning by a non-monopolistically situated supplier, by this Court in *Federal Trade Commission* v. *Gratz*, 253 U. S. 421.

In *U. S.* v. *U. S. Steel Corp.*, 251 U. S. 417, this Court found no illegality in the activities of the U. S. Steel Corporation, which did some 41% of the steel business at the time of suit (pp. 438-9, 442), one of the most evident things about which was the fact that *it was an integrated business.* This the Court carefully noted more than once in its opinion, saying for example, at p. 438: "The tendency of the industry and the purpose of the corporation in yielding to it was expressed in comprehensive condensation by the word 'integrated' which signifies continuity in the process of the industry from ore mines to the finished product".

No case in this Court decided since the *Steel* case, of which we are aware, has condemned integration as a method of providing outlets for products manufactured by affiliated concerns. That section of the Government's brief as Appellant which deals with this question (pp. 90-114) cites no case which we believe can be fairly held to have such significance.

At the time this case was instituted in 1938 integration had obtained in the industry for 20 years, and the major defendants had been integrated for periods ranging from

10 to 20 years. (Paramount bf., pp. 22-26). Prior to 1938, so far as we know, the Government never made the claim that integration in the motion-picture industry was illegal. At any rate it never succeeded in putting the idea over. Integration has, of course, been a commonplace thing in many other industries, including oil and motors.

In making franchises with theatre chains, we obviously achieve a much less fixed relationship with the theatre chain than each of the major distributors has with its affiliated theatre chain. Our relationship is for a few years at the most. By means of the relationship which they have, each of their theatres is assured of a permanent franchise for their first-class product. The Court below held that such a relationship was legal, and yet held that our much more fragile relationship involved in our franchises was illegal *per se*. This simply does not make sense.

It is asserted by the Government (Gov. bf., p. 42) that the reason why franchises with theatre chains which are known as master contracts are illegal *per se* is that such an agreement (1) ties up a substantial segment of the playing-time available in the circuit's theatres for a period of years, without regard to the merits of the licensor's product, and thus prevents other distributors from competing for that playing-time upon the merits of such films as they may have available during those years; and (2) commits a substantial part of the available film supply to the circuit's theatres without any consideration of the merits of competing theatres as outlets for the product.

It thus makes the argument that exhibitors do not know what they are doing, when they commit themselves to licensing our pictures over a period of years, and have no comprehension in respect of the merits of our pictures.

If by past experience the exhibitors did not know pretty well what they would get in our pictures, and did not feel that it was to their advantage to commit themselves to license them, as against the mere hope of more suitable competitive pictures arriving on the scene, it is quite plain that they would not enter into the franchises with us.

Likewise the Government's argument that when we license a chain of theatres, we do so completely unaware of what we might obtain from the theatres in competition with them is wholly unrealistic. Our long experience in the business obviously makes us well aware of the film-rental paying capacities of every theatre in the country. No attempt was made by the Government moreover to prove that in the aggregate, or even in some instances, better offers were made by the theatres in competition with the various theatres in the licensed chain. It simply assumes that we might have made a better deal with them or some of them.

As "an extreme example" of an illegal franchise with a theatre chain, the Government refers to our Interstate Circuit franchise, G. X. 261, printed at pp. 50-58 of the Appendix to its brief.

This agreement expressly provides in Item 12 that "All first-run product is to be dated and played within availability period, otherwise product will be considered automatically available for subsequent-run bookings". In the *Griffiths* case* the Government made two main objections to master agreements. The failure to include this clause was one of them. The other objection was to a lump-sum film rental. In this franchise the lump-sum payment of

*U. S. v. *Griffiths Amusement Co. et al.*, 68 Fed. Supp. 180.

$260,000, payable at the rate of $5,000 a week, is only a tentative basis determined upon in order to assure us of being paid in something like proper weekly amounts as we supply the pictures. It is nothing but a financing device. As item 3 in the franchise shows, each of the 44 features is valued at $3,750, and the three Frank Lloyd productions at $8,000. These are the principal pictures licensed.

The number of pictures in each category to be delivered to each theatre in each town is stated, and these vary somewhat in number. The varying number of days each theatre is to have the pictures is stated. For the second season, a review and revision is provided for to determine whether the $5,000 weekly payment should be revised upward or downward (item 15). A like review and revision is provided for in respect of the third season (item 16). The exhibitor agrees to play the product on substantially the nationally designated percentage terms, as set up by the distributor, which designations are to be mutually agreed upon, based on performance. Thus specific film rental terms are contemplated for each feature picture. If such terms result in film rentals in excess of $260,000, then the exhibitor is required to pay the distributor one-half the excess.

From the foregoing it can be readily seen, since we have heretofore shown that the quantity of pictures dealt with and the number of theatres dealt with are not legally objectionable, the Government's criticism of this franchise is ill-conceived. It is the only one of our seven franchises in evidence which even mentions a tentative lump-sum film rental.

It is thus evident that when we made franchises, indiscriminately with independent exhibitors and affiliated exhibitors, whether single theatres or chains, in order to secure

as firm outlets as possible for our pictures, with as wide a theatre coverage as possible, we were fully justified in believing these agreements to be lawful, and, contrary to the Government's artful suggestion, do believe that they are fully lawful. If any of the theatre chains were, as the Government claims, engaged in conspiracies against their smaller competitors, and were aided therein by having the use of the pictures which we supplied, this is not a consequence which can be charged to anyone but those who were engaged in such conspiracies. The remedy, of course, would be to enjoin them from enforcing such franchises as was done in the *Crescent* case. We are no more responsible for any abuse thereof than we would be if we were an independent power company, and had made a contract with the *Aluminum Company of America* to supply it with our output of power for its electrolytic installations at many of its plants over a period of years, thus enabling it to make aluminum for sale to the public at monopolistic prices.

Respectfully submitted,

THOMAS TURNER COOKE,
CHARLES D. PRUTZMAN,
Counsel for the Universal Appellants.

ADOLPH SCHIMEL,
CYRIL S. LANDAU,
FRANK W. FORD,
Of Counsel.